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## THE PRESENT PERIOD OF INCOME TAX ACTIVITY IN THE AMERICAN STATES.

### SUMMARY.

Increased attention to state income taxes since 1895, 296.—Bills introduced in several states; laws passed in South Carolina and Oklahoma, 300.—Discussion by Tax Commissions, 303.—Constitutional limitations removed in five states, 304.

WHAT political laboratories our forty-six American states are! How many a costly venture could be avoided if the experiments tried and the results obtained in each were studied by all! Impelled by this conviction, the author began a study of the income tax in the commonwealths of the United States some years ago.<sup>1</sup>

As stated in the results of that investigation, there have been three periods of income tax activity in the United States: the first from about 1840 to 1850; the second from 1860 to 1870; and the third, or present period of activity, which began about 1895. The keen interest in the subject during recent years is evidenced by the fact that since 1895 sixteen states and three territories have paid attention to the tax either by constitutional amendment, legislative enactment, or in commission reports.

The four states employing the tax at the beginning of this period—Massachusetts, Virginia, North Carolina, and Louisiana—have been little affected by the recent movement. The law in Massachusetts, as it has stood since 1873, provides that "income from any profession, trade, or employment shall not be construed to be personal estate for the purpose of taxation except such portion as exceeds the sum of \$2,000 per annum; provided, however, that no income shall be taxed which is derived from any

<sup>1</sup> See *The Income Tax in the Commonwealths of the United States*, Publications of the American Economic Association, vol. iv., 1903.

property or estate which is the subject of taxation.”<sup>1</sup> This act, which was the result of a compromise, has yielded little revenue to the state. Indeed, it has been asserted by the tax commissioner that “the machinery of the Massachusetts tax laws is not adapted to the enforcement of an income tax, and until it is, the income tax can never attain a prominent place in our system.” And this statement was made after the appointment of a deputy tax commissioner, whose duty it is to visit each city and town in the state for the purpose of obtaining greater uniformity in taxation.

Virginia, likewise, has been apparently uninfluenced by the present activity. While she has the somewhat unique practise of frequently re-enacting her revenue law, she has, for more than a generation, made little change in her income tax. For some time all forms of income—rent, wages, interest, and profits—have been taxed. Besides certain specified deductions, a general exemption ranging from \$600 to \$1,000 has been allowed. The present law, enacted in January, 1908, provides for the taxation of “the aggregate amount of income in excess of \$1,000, whether received, or due but not received, within the year next preceding the first of February in each year.” The law then proceeds to enumerate in detail the sources of the rent, interest, salaries, and profits upon which the rate may be levied. It further declares that in addition to the exemption of \$1,000 any person may also deduct all losses sustained during the years.<sup>2</sup> The administration of the law rests with the local authorities, the incomes being assessed by the local assessor and the tax gathered by the local tax collector.

The revenue derived from the tax has been slowly increasing in amount. In 1900 it amounted to \$46,023, in 1901 to \$58,254, in 1902 to \$62,221, in 1904 to \$71,225, and in 1906 to \$94,367. While this gradual increase in the receipts from the tax is encouraging, and the total amount

<sup>1</sup> Laws of Massachusetts, 1873, chap. 354.

<sup>2</sup> Chap. 10, sec. 10, Laws 1908.

is considerable when compared with that received in other states from the same source, the amount is still unimportant and the increase small when compared with the total tax of the state.

The state of North Carolina has had a continuous experience with the income tax since 1849. Altho the law was always simple in form, it reached wages, interest, and profits, and, during a portion of the time, rent. In 1893 the present movement was initiated by the enactment of a new law, containing more specific provisions and introducing a progressive rate.<sup>1</sup> This progressive rate upon income from sources other than taxable property was doubled in 1895,<sup>2</sup> and, as thus changed, continued in force until 1901. In the latter year the law abolished the progressive rate and substituted a proportional rate of 10 per cent. upon all incomes in excess of \$1,000, except such as were derived from property already taxed. In reply to a series of written questions the tax-payer was required to list, in itemized form, his gross income from all sources except property taxed. The assessor was made subject to a penalty of five dollars for each question unanswered, the County Commissioners being empowered to collect the fine. Or any individual might bring suit against the assessor and receive one-half the amount recovered for his pains. No local unit—city, township, or county—was permitted to levy the tax while the state law was in operation.<sup>3</sup>

The law of 1905 materially changed the law of 1901. The tax-payer was required simply to declare under oath the amount of his gross income in excess of \$1,000 from "salaries, fees, trade, profession, and property not taxed." It was made unlawful to publish the income tax list or any part of it, the penalty for such offence being not more than fifty dollars or thirty days' imprisonment. But the assessor might report to the Corporation Commissioner those listed for the income tax and those he thought should be listed,

<sup>1</sup> See *Income Tax in the Commonwealths of the United States*, p. 71-72.

<sup>2</sup> *Laws of 1893*, chap. 116, Schedule A, sec. 5.

<sup>3</sup> *Laws of 1901*, chap. 9, secs. 28-31.

and the Corporation Commissioner was permitted to take such steps as he deemed necessary to secure the assessment and collection of such taxes.<sup>1</sup> This law of 1905 was re-enacted in 1907<sup>2</sup> and is in force at the present time.

The state of North Carolina shows an increase of revenue from her income tax during the present period. The law of 1895 yielded in the following year \$3,460, while the total state tax was \$604,542. In this year, 1896, of the ninety-six counties, thirty-nine returned the tax. Three years later, in 1899, the income tax revenue had slowly advanced to \$4,399, while the state tax had increased to \$723,307, and fifty-eight of the ninety-six counties now returned incomes.

The appointment of a State Tax Commission about 1900 was in harmony with the new movement. By issuing a pamphlet of instructions to the assessors, explaining the law, and by carefully supervising the assessments, this commission added, in round numbers \$41,000,000 to the assessment roll in 1901. It increased the revenue from the income tax from \$5,014 in 1900 to \$19,030 in 1901.<sup>3</sup> In that year eighty-one of the ninety-seven counties reported the tax. The receipts from it steadily advanced after 1901, until in 1907 when they amounted to \$35,958. The total state tax during the same period increased about \$100,000.<sup>4</sup>

The Tax Commission in its report of 1902 said, in regard to the income tax, "there may be some difficulty in working out at first satisfactory details for the assessment and collection of this tax, but it can be done."<sup>5</sup> Altho their report of 1904 contains a number of recommendations for the improvement of the revenue laws, no suggestions are found regarding the income tax.<sup>6</sup> Indeed, the state auditor says of the present law, "This is about the best law, I think, we can have in the state and keep within bounds of the constitutional limitations." He further says, "The law of

<sup>1</sup> Laws of 1905, chap. 588, secs. 22-25.

<sup>2</sup> Laws of 1907, chap. 256, secs. 22-25.

<sup>3</sup> Tax Commission Report, 1902, pp. 1-17.

<sup>4</sup> Annual Reports of the Auditors, 1901-07.

<sup>5</sup> Report, 1902, p. 17.

<sup>6</sup> Report 1904, pp. 1-11.

course is in its infancy, and will work better as the years go by, and the increase will be correspondingly greater, I think, in the years to come." The present Clerk of the Corporation Commission says: "The law is proving satisfactory as far as it goes. A great many are of the opinion that it should reach income from all sources; however, this is a question in which there is a difference of opinion."

Louisiana is the one state that has discontinued the taxation of incomes during the present period of activity. She first levied a tax upon incomes in 1865. Tho it continued until about 1900, the law was never generally enforced. The receipts of the tax slowly advanced from \$2,476 in 1868 to nearly \$25,000 in 1880, but soon began to decline. In 1899, when but two of the fifty-nine counties in the state reported incomes at all, the total receipts amounted to only \$104. The reports since 1900 make no mention of the tax whatever.

It is of no small significance that, of the thirteen states abandoning the tax prior to the present period of income tax activity, only one, South Carolina, has revived it during the time. Altho she experimented with the income tax continuously from 1701 to 1868, it proved of little account as a source of revenue. In the latter year it was discontinued, and was not revived until after the adoption of the present constitution, in 1895.

Influenced by the reform movement, desirous of attaining greater justice in the distribution of the burden of taxation and of keeping the general tax rate low, the convention inserted a clause in the new constitution empowering the legislature to levy a "graduated tax on incomes."<sup>1</sup> In the following year, 1896, a bill providing for an income tax was introduced into the legislature, but after prolonged debate it was defeated. The next year another bill was introduced, and, after equally animated discussion of both the rate and the exemption,<sup>2</sup> a committee of conference fixed

<sup>1</sup> Constitution of 1895, Art. X., sec. 1.

<sup>2</sup> See *The Income Tax in the Commonwealths of the United States*, pp. 88-90.

the exemption at \$2,500, and the bill became a law in March, 1897, to go into effect on January 1, 1898.<sup>1</sup> This law, which is still in force, provides that there shall be levied upon "the gains, gross profits and income" annually received by any citizen of the state from any source whatever, "a tax of one per cent. on the amount so derived over and above \$2,500 and up to \$5,000, one and one-half per cent. on \$5,000 and over up to \$7,500, two per cent. on \$7,500 and over up to \$15,000, and three per cent. on \$15,000 and over." Besides the general exemption of \$2,500 it was further provided that interest upon United States bonds and state bonds should not be taxed, and, in computing the incomes, necessary expenses actually incurred in carrying on the business, occupation, or profession were to be deducted. That those subject to the tax might feel free to declare their income, it is made unlawful, under penalty, for any officer to disclose or allow to be made known in any way any particulars regarding the amount or source of income, profit, or expenditure returned by any person.<sup>2</sup> The legislature apportions the amount of tax to be raised among the counties, and the county officials levy and collect it at the same time and in the same manner as other taxes. The county auditors are made particularly responsible for the enforcement of the law.

In 1898, the first year, the tax yield amounted to \$5,085, in the next year it fell to \$1,660, and in no one of the three succeeding years did it amount to \$1,000. In 1903 it returned to \$1,041, in 1904 it advanced to \$1,120, in 1905 to \$1,769, in 1906 to \$9,155, and in 1907 it fell to \$7,060. The total state tax between 1898 and 1906 increased over \$300,000, amounting in the latter year to nearly \$900,000.<sup>3</sup> The slight advance in the receipts from the income tax in 1906 and 1907 is attributed by the present State Treasurer to an "effort on the part of some county officers to enforce the law." As a matter of fact, at no time since its incep-

<sup>1</sup> See *The Income Tax in the Commonwealths of the United States*, pp. 88-90.

<sup>2</sup> *Laws of 1897*, No. 335, p. 529.

<sup>3</sup> *Treasurer's Reports*, 1898-1906.

tion has the tax given general satisfaction. Scarcely has a session of the legislature passed without there being a strong effort made to secure the repeal of the tax.

While South Carolina is the only state willing to repeat her experience with the income tax, still others are ready to experiment. Oklahoma has already enacted an income tax law. It went into effect in May, 1908. It requires the assessor to put the following question to each tax-payer: "Was your gross income from salaries, fees, trade, profession, and property upon which a gross receipt or excise tax has not been paid, any and all of them, for the year ending June 30 last preceding, in excess of \$3,500?" If the question is answered in the affirmative, the party is to certify in writing and under oath the amount of excess income. This sworn statement is sent to the State Auditor who certifies the amount of the tax due, and reports it to the clerk of the county in which the person resides, who places it upon the tax roll. It is then collected at the same time and in the same way as the general taxes. The rate is five mills (one-half of 1 per cent.) on the amount in excess of \$3,500 and less than \$5,000; seven and one-half mills between \$5,000 and \$10,000; twelve mills between \$10,000 and \$20,000; fifteen mills between \$20,000 and \$50,000; twenty mills between \$50,000 and \$100,000; and thirty-three and one-third mills ( $3\frac{1}{3}$  per cent.) on all amounts in excess of \$100,000. That every one may feel free to return the full statement of his income, it is made unlawful to print any part of the income tax returns unless the tax upon the income is delinquent. To swear falsely is made perjury, and an assessor failing to perform his duty is declared guilty of malfeasance in office and required to forfeit the amount of tax lost to the state.

The Oklahoma act is too recent to determine the results, but, judging from the experience of other states, the very high exemption of \$3,500 will materially lessen the revenue. Again, the tax being upon gross receipts, it will distribute the burden unjustly, since those in business will be required to pay on their total income, while, with few exceptions,



salaried persons, because of the high exemption, will not be subject to the tax at all.<sup>1</sup>

Several of the states have endeavored to enact an income tax law, but without success. In 1899 Michigan, under the influence of Governor Pingree, tried to levy a tax upon incomes in excess of \$1,000. Minnesota and Oregon have since introduced income tax bills with a rate, in each, ranging from 1 to 3 per cent. But none of them has passed. However, the contest in these states is not yet closed.

Another evidence of growing interest in the income tax is the fact that, while over forty state tax commissions were appointed prior to 1895, only seven treated the income tax, but during the short period since that date six have considered it. The Massachusetts Tax Commission of 1897, after a careful consideration of the advantages and disadvantages of the law in that state, recommended the repeal of the tax.<sup>2</sup> The Michigan Commission in its report of 1900 sets forth the reasons commonly advanced in favor of the income tax, but refrains from making any recommendation.<sup>3</sup> The Revenue Commission of Colorado in its report of 1901 says: "Legitimate incomes are derived from three sources, labor, capital, and legalized privileges. A tax upon labor and capital would be a grievous burden, so, if an income tax is to be levied, it should be placed so heavy upon privileges as to absorb them before taxing the income of labor and capital." It goes on to say, "If we must tax incomes from labor and capital, as well as incomes from privileges, it surely is much better and less evasive to tax the values of the products and privileges direct rather than to bother with their incomes."<sup>4</sup> The two reports of the North Carolina Commission, the one of 1902, the other of

<sup>1</sup> The territory of Hawaii, as early as 1896, began a most successful experience with the general income tax. In 1905 the receipts equalled more than one-sixth the total tax. They amounted to \$326,733, while the entire tax equalled \$1,941,184. Limited space makes a discussion of the tax here impossible.

<sup>2</sup> Report of Commission of Taxation, 1897, p. 85 *et seq.*

<sup>3</sup> First Annual Report of Board of State Tax Commissioners, 1900, p. 32.

<sup>4</sup> Revenue Commission Report, 1901, pp. 17-19.

1904, reveal the success of the commission in placing property upon the assessment roll. Incomes returned increased from \$926,144 in 1900 to \$2,454,204 in 1904. In the report of 1902 the commission asserts that "there may be some difficulty in working out, at first, satisfactory details for the assessment and collection of this tax, but it can be done."<sup>1</sup> Two members of the New York Special Tax Commission recommended for passage an amendment of the tax law providing for a graduated income tax. Incomes less than \$1,500 were exempted, and the rate on those over \$1,500 ranged from 1 to 10 per cent. A rigid method of administration was also favored.<sup>2</sup> And the Wisconsin State Tax Commission in its report of 1907 says: "The very inefficient manner in which the personal property tax has been assessed and the resulting gross inequalities in taxation, as well as the agitation of the subject of credit exemption, have brought about," in that state, "the pending constitutional amendment authorizing a graduated income tax." It then proceeds to report a very interesting and suggestive investigation showing the tax rate upon different classes of property and comparing it with the income derived therefrom.<sup>3</sup>

Nor has the spirit of reform stopped with legislation and the reports of commissions. In a number of states the people are demanding that, by revision or amendment, the constitution be changed so as expressly to empower the legislature to levy an income tax. As already stated, South Carolina adopted a new constitution in 1895 in which was inserted a clause which permits the general assembly to levy "a graduated tax on incomes."<sup>4</sup> This was the first of her constitutions to make such a provision, tho she had levied an income tax for nearly one hundred seventy years. Utah, in the same year, also adopted a constitution which declared that "nothing in this constitution shall be construed to prevent the legislature from providing . . . a

<sup>1</sup> Report of 1902, p. 17.

<sup>2</sup> Report of Special Tax Commission, 1907, pp. 179-185.

<sup>3</sup> Report of 1907, pp. 30-38.

<sup>4</sup> Constitution, 1895, Art. X., sec. 1.

tax based on incomes.”<sup>1</sup> In 1902 Virginia for the third time since 1850 framed a new constitution which granted to the general assembly the power “to levy a tax on incomes in excess of \$600 per annum.”<sup>2</sup> In November of the following year (1903) an amendment to the Kentucky constitution was adopted by the people of that state, permitting the legislature, by general law, to authorize cities and towns to levy a tax on personal property based on income, licenses, or franchises in lieu of an ad valorem tax on certain quasi-public corporations. But in November, 1902, the voters of Minnesota rejected an amendment submitted to them, empowering the legislature to levy a tax upon incomes in excess of \$1,000 per annum arising from property not taxed, the rate never to exceed 10 per cent. upon income from credits or 4 per cent. upon income from other property. Oklahoma, on the other hand, when she attained statehood in 1907, expressly granted the legislature the power to levy an income tax.<sup>3</sup> As already observed, the legislature promptly took advantage of the right. Last November three states submitted to the voters amendments pertaining to the taxation of incomes. California sought to enlarge the powers of the legislature; South Dakota, to allow the legislature to “classify incomes” and provide for “a graduated or progressive tax thereon with such exemptions as it may prescribe”; and Wisconsin, after several years of effort, proposed to permit the legislature to tax incomes, “which tax may be graduated or progressive, and reasonable exemptions may be allowed.” The amendment to the Wisconsin constitution was adopted, but those to the constitutions of California and South Dakota were lost because of opposition to accompanying provisions. The legislature of California, however, may still tax incomes according to a right expressly granted by the constitution of 1879. This very general movement to clear the way constitutionally for an income tax has

<sup>1</sup> Constitution, 1895, Art. XIII., sec. 12.

<sup>2</sup> Constitution, 1902, Art. XIII., sec. 170.

<sup>3</sup> Constitution, 1907, Art. X., sec. 12.

significance. Altho some still consider the action unnecessary, yet it is this very important first step which the states deem expedient.

A study of the present period of income tax activity, here so briefly reviewed, affords the author no occasion to modify conclusions previously expressed.<sup>1</sup> The current movement is not due to the success of the tax in any state, but rather to the spirit of reform now sweeping the country. This movement would scarcely leave untouched the subject of taxation, where injustice is so common. The people have turned to an income tax because they believe in the theory that individuals should contribute to the support of the government according to ability, and that income is the most just measure of that ability. They expect success because they are possessed of the characteristic American optimism, and know little of the difficulties of administering such a law. Whether this demand, urgently expressed in so many of the states, be wise or not, it must be reckoned with. Indeed, legislatures have already done something, tax commissions more, but constitutional changes most, to prepare the way for a sane and scientific law. It is left for some one or more of the states contemplating such a tax to empower a commission to make a thoro study of both home and foreign experience in this field, with a view to framing a law. Such a law should provide for reaching each form of net income, for its own administration in detail, for compelling officials to perform their duty, and for preventing tax-payers from evading the law. All interested in tax reform should welcome any such effort, and in every way possible contribute to its success.

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<sup>1</sup> See *The Income Tax in the Commonwealths of the United States*, pp. 116-121.